IN THE

Supreme Court of the United States

OCTOBER TERM 1945.

No. 223

IN THE MATTER
—OF—
1934 REALTY CORP.,

Debtor.

PRUDENCE REALIZATION CORPORATION,
Petitioner,

THE HURD COMMITTEE, the PETITIONING CREDITORS, and CARROLL DUNHAM 3rd and EDWARD K. DUNHAM as Trustees of the Estate of DAVID DOWS,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

EUGENE BLANC, JR.,
Counsel for Respondents.

ALPERT PRESS, BROOKLYN, N. Y., TEL. TRIANGLE 5-1058-1059

SUBJECT INDEX.

Cases.

Statutes Cited.

Supreme Court of the United States

OCTOBER TERM 1945.

No.

IN THE MATTER

—OF—

1934 REALTY CORP.,

Debtor.

PRUDENCE REALIZATION CORPORATION,

Petitioner,

THE HURD COMMITTEE, the PETITIONING CREDITORS, and CARROLL DUNHAM 3rd and EDWARD K. DUNHAM as Trustees of the Estate of DAVID DOWS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinions of the District Court has not been reported. The opinion of the Circuit Court has not yet been officially reported (R., p. 156).

STATEMENT.

This petition presents nothing more than the same question of subordination in bankruptcy of claims acquired by a defaulting guarantor after default and after maturity, which has already been passed on by this Court twice at the instance of the same petitioner in connection with the reorganization of securities guaranteed by petitioner's predecessor The Prudence Company, Inc. (*Prudence Realization Corporation* v. *Geist*, 316 U. S. 89 and *Prudence Realization Corporation* v. *Ferris*, 323 U. S. 650), as well as in numerous other cases in this Court (e.g. *U. S.* v. *National Surety Company*, 254 U. S. 73; *Jenkins* v. *National Surety Company*, 277 U. S. 258; *American Surety Company* v. *Westinghouse Electric Manufacturing Co.*, 296 U. S. 133) and in the Circuit Courts of Appeal (e.g. *American Surety Company* v. *Sampsell*, 148 F. (2d) 986 [C. C. A. 9th, 1945]; *In re Prudence-Bonds Corporation*, 102 F. (2d) 531 [C. C. A. 2nd, 1939]). In the *Geist* and *Ferris* cases, the question came up as it has here, in connection with the subordination of guaranteed mortgage certificates reacquired by the defaulting guarantor, The Prudence Company, Inc.

No new principles are involved here, and petitioner has failed to show the necessity for having this Court rule upon the same question upon identical facts * for a third time. Nevertheless, petitioner in its brief has resorted to inaccuracies and distortions, and has improperly phrased certain of its statements and arguments with what have been called "loaded words" and "slanting expressions",** so that correction and restatement have been made necessary.

---

* By stipulation, a substantial part of the record in the *Ferris* case was made a part of the record here (R., p. 156, Stipulation, Par. 15, R., p. 18).

** See S. I. Hayakawa, "Language in Action."

A.

The Creation of the Certificate Issue.

On July 17, 1925, The Prudence Company, Inc. (hereinafter called "Prudence"), became the owner of consolidated bonds and mortgages on real property at 10 West 86th Street, New York City, now owned by the present debtor, 1934 Realty Corp. The bonds and mortgages were assigned without consideration by Prudence, to its wholly controlled affiliate, Prudence-Bonds Corporation, pursuant to a scheme whereby the latter was to issue certificates participating therein. Prudence-Bonds Corporation delivered the bonds and mortgages to a Depositary under a letter of deposit (Stipulation, Ex. A, R., p. 19). On December 13, 1937, by order of the United States District Court for the Eastern District of New York in the reorganization of Prudence-Bonds Corporation, the mortgages were formally assigned to the Depositary (Stipulation, par. 1, R., p. 13).*

Prudence executed an instrument of guaranty dated August 3, 1925 (Stipulation, par. 3, Ex. C, R., p. 25), and endorsed on each certificate sold, its statement that it had guaranteed to the owners and holders of the certificates the payment of interest when due and the payment of the principal when due or within eighteen months thereafter (Ex. B, R., p. 30). Certificates, known as the "Tigo Certificates", were then issued and sold to various persons to the full amount of the mortgage. At the commencement of this proceeding, certificates were outstanding in the aggregate principal sum of $403,975.00 (Stipulation, par. 4, R., p. 14). Of these, $127,359.06, in aggregate principal amount or about 31.5 per cent. of the total outstanding had been reacquired by Prudence, as in the *Ferris* case (R., p. 156), by the methods, under the circumstances, and at the times hereinafter described. Such certificates are now held

* *Cf.*, the statement in petitioner's brief (p. 5) that the certificates were "turned over to Prudence in compensation for its assignment." There is no justification for this statement in the record.

by petitioner as transferee of all the assets of Prudence, pursuant to the bankruptcy reorganization of the latter in the United States District Court for the Eastern District of New York. The balance of the certificates, aggregating $276,615.94 are held by various persons other than petitioner.

Both the certificates and the underlying bonds and mortgages matured on October 1, 1932. Neither the mortgages nor the certificates were paid at that time (Stipulation, par. 13, R., p. 17). Both were therefore in default from then on, although such default could not then be enforced against the guarantor because of an eighteen months' grace clause in the instrument of guaranty.

B.

The Financial Condition of the Guarantor at the time of the Reacquisition by it of the Certificates.

One basis for the decision herein is that the defaulting guarantor reacquired its certificates in connection with its guarantee obligations and as a method of reducing those obligations *pro tanto*. Hence, petitioner, the transferee in the bankruptcy reorganization of the guarantor, is in the position of a "partial subrogee", and not entitled to compete with other creditors whose guarantee claims have not been paid in full.

The circumstances of the reacquisitions are in direct contrast to those in *Prudence Realization Corporation* v. *Geist, supra,* in which the reacquired certificates were given parity. On the other hand, they are identical in legal significance with those in *Prudence Realization Corporation* v. *Ferris, supra,* particularly as developed in the concurring opinion of Mr. Chief Justice Stone and Mr. Justice Rutledge. Hence, it is necessary to review briefly the financial background of the guarantor against which the reacquisitions must be projected.

As already stated, the Tigo mortgage and certificates matured on October 1, 1932, and were not paid. During 1931, the year preceding maturity, the asset position of the

guarantor had deteriorated tremendously. As at June 30, 1931, its cash balance had been over $3,400,000; as at December 31, 1931, it was only $783,738.08. Its other assets at the latter date consisted of marketable securities amounting to only $168,045.25 (less than half of the corresponding item as at June 30, 1931) and notes and accounts receivable amounting to $1,563,459.63 (as contrasted with over $2,300,000 for the same item as at June 30, 1931). The balance of its assets were either pledged assets, or the guarantor's own securities, or those of affiliated companies (Stipulation, Ex. E, R., p. 31).

On the other hand, the guarantor was faced during the year 1932 with maturities of securities guaranteed by it, aggregating $22,791,433—an increase of $21,816,333 over the comparatively small total of maturities of $875,100 for the year 1931. Clearly, in view of the increasing defaults by mortgagors, its assets were insufficient to pay these increasing maturities. The pyramiding of its maturities is dramatically shown by the table of maturities of obligations guaranteed by The Prudence Company, Inc., for the eleven years 1927 to 1937, as follows:

1927	$ 100
1928	1,000
1929	2,600
1930	2,400
1931	875,100
1932	22,791,433
1933	32,488,177
1934	40,162,715
1935	26,230,120
1936	16,096,161
1937	10,676,186

(Stipulation, par. 12, R., p. 17).

As at December 31, 1932, the balance sheet still showed inability to meet the maturities, even giving effect to the $20,000,000 loan from Reconstruction Finance Corporation hereinafter referred to. The liabilities had increased by $17,000,000 during the year 1932, without taking into account what were called "contingent" liabilities on the guaranties, which amounted to over $159,000,000 matured and unmatured. (Stipulation, par. 10, Ex. F, R., p. 33.)

From these figures emerges the inexorable fact that the collapse of the whole structure was inevitable, since the mortgages themselves were admittedly not worth their face amounts. The directors were not blind to this and moved in three directions to stave off the obvious end as long as possible.

First: In November, 1931, Prudence opened negotiations for a loan from Reconstruction Finance Corporation. On February 16, 1932, it formally applied for a loan of $25,000,000 (Stipulation, par. 7, R., p. 15). This loan was granted to the extent of $20,000,000 on June 7, 1932 (Stipulation, par. 11, R., p. 17). The guarantor's Assistant Treasurer testified that the loan was necessary "for us to keep on as a going concern" (R., p. 51; fol. 153).* The statements of the Company in its application for the loan are of the greatest significance (Stipulation, par. 8, R., pp. 15-16). Of the $25,000,000, $5,000,000 was requested for the purpose of acquiring equities under foreclosure, $5,750,000 was requested to retire bank loans maturing within the next sixty days, and $12,000,000 was requested "to renew maturing mortgages". In connection with this last item of $12,000,000 (which is more than half of the loan ultimately made), the application stated frankly that the properties, if foreclosed, would bring "only a fraction of the amount originally conservatively loaned thereon", and thereby necessarily admitted that the guaranty liabilities

* *Cf.*, the gratuitous statements in petitioner's brief: "When Prudence applied for a loan from Reconstruction Finance Corporation, it did not contemplate cessation of business," (p. 15) and "The securing of the loan was consistent with Prudence's continuance in business," (p. 22).

could not be met out of the properties, and that without the loan the guarantor was unable to make good its obligations.*

Second: The guarantor took advantage of the eighteen months grace clause in its guaranty. On January 1, 1932, it notified the holders of the certificates that it had suspended principal payments (Stipulation, par. 6, R., p. 14; fol. 42).

Third: The guarantor attempted to reduce or postpone its guaranty liabilities by acquiring Tigo certificates at a discount, or by exchanging Tigo certificates for other certificates of later maturities. This process began on August 11, 1932 and continued until January 24, 1933, by which time the guarantor had repurchased or reacquired Tigo certificates aggregating $127,359.06 in principal amount (Stipulation, pars. 4 and 5, R., p. 14; Ex. D, R., pp. 23-24).

Three methods were used to acquire certificates. One method was the use of a secret concealed brokerage account known as the "Pender-Buckbee-Merriam" account, known only by a number (R., p. 52; fol. 155). The second was the direct purchase from the certificate holders at the maximum discount that was possible in each individual case. The third method was the exchange of the Tigo certificates for another certificate of a maturity later than October 1, 1932, which later date was the maturity date of the Tigo certificates (Stipulation, par. 5, Ex. D, R., pp. 23-24).

These three methods are exactly the same as those followed in the *Ferris* case. The first Tigo certificate was acquired August 11, 1932. In September, $24,609.06 of certificates were purchased. In October, the month of maturity, $17,800 of certificates were purchased. In November, the month following maturity, $45,850 of certificates were purchased. The balance were acquired in December of 1932 and January,

* There is no testimony that any of this money was ever used "to renew maturing mortgages"; certainly it was not used to renew the Tigo mortgage—nor was the suspension of principal payments ever revoked.

1933, likewise after maturity and after default (R., pp. 23-24, Ex. D).

On March 4, 1933, the guarantor was taken over by the Superintendent of Banks of the State of New York. In 1935 the debacle so clearly forseen by the guarantor occurred, and it filed its petition in the bankruptcy court under Section 77-B. The United States District Court for the Eastern District of New York approved the petition on February 1, 1935; appointed trustees, and later adjudicated the guarantor to be insolvent (Stipulation, par. 16, R., p. 18, Ex. H. R., p. 71).

Petitioner was formed pursuant to the reorganization plan confirmed in said proceeding, to take over and realize on all the assets of the defaulting guarantor. Neither that plan, nor any order in the proceeding, including the order of confirmation, attempted to fix or adjudicate the value of the assets so transferred, among which were the Tigo certificates acquired by the guarantor as aforesaid. The plan, however, recognized specifically that the question of the parity of these certificates had been raised and that if it were decided adversely to the guarantor, the value of the Tigo certificates as an asset of the bankrupt would be less. It accordingly provided that if there should be

> "uncertainty whether certificates of such issue held in the Debtor's estate on the Effective Date are on a parity with other certificates of such issue, the deduction to be made pursuant to the foregoing clause (1) shall be based in the first instance on the assumption that the certificates so held in the Debtor's estate are not entitled to parity, and an appropriate reserve shall be established by the New Company to provide for the additional distribution to be made to certificate holders of such issue if the Board of Directors shall be later satisfied that such parity exists; the Board of Directors being authorized to discontinue such reserve if and when satisfied that such parity does not exist; * * *" (R. 71).

"Debtor" in the foregoing quotation means the guarantor, Prudence, and "New Company" means the present petitioner.

The plan also recognized that many of the certificate holders had dealt, or would deal, with their certificates and the underlying mortgages in separate reorganizations thereof. It was feared that such dealings might affect their rights to participate in the plan, and in order to prevent such a result and to anticipate the argument that such dealings might constitute a waiver of claims, such as the claim to subordinate the guarantor's certificates, the guarantor's plan provided that unless a guaranty claim should have been expressly withdrawn, released, compromised or expunged,

> "* * * no action taken subsequent to February 1, 1935, by or on behalf of any holder of a guarantee claim against the Debtor with respect to his Collateral shall bar any such claimant from participating in the benefits of the Plan to the extent herein provided" (R. 71).

"Collateral" means the mortgage underlying the certificate issue, and February 1, 1935 is the date of the approval of the guarantor's petition for reorganization.

The District Court's order confirming the guarantor's plan of reorganization further recognized that equities in favor of third persons might exist, and accordingly when it directed the transfer of the assets to petitioner it provided as follows (R. 71):

> "The Section 77-B Trustee of the Debtor is hereby further directed to transfer to the New Company forthwith, subject to all then existing equities and rights of third parties therein, all assets held by said Section 77-B Trustee for the account of others or held by said Section 77-B Trustee in any agency or other segregated account, pending settlement or determination of equities or rights asserted by others. * * *"

C.

The Reorganization Proceeding of this Debtor and the Orders Appealed From.

An involuntary petition for the reorganization of this debtor under Chapter X was filed by respondents, as petitioning creditors. It was approved and a trustee appointed. Thereafter, the Depositary filed a so-called "blanket" proof of claim on behalf of all outstanding certificates, without differentiation between the certificates reacquired by The Prudence Company, Inc. and the publicly held certificates (R., pp. 6-9). Respondents filed objections on the ground that it failed to make such differentiation (R., pp. 10-12).* Thereafter, the stipulation of July 16, 1942 was entered into (R., p. 13), and after a hearing thereon the District Judge held that *Prudence Realization Corporation* v. *Geist, supra*, required him to grant parity to petitioner's certificates (R., p. 73). An order overruling the objection was entered on October 8, 1942.

Thereafter, the Trustee proposed an amended plan of reorganization, which necessarily granted parity to petitioner (R., pp. 80-91). The plan provided for the satisfaction of the mortgage, the transfer of the property to a new corporation, and the issue of stock in the new corporation to all the certificate holders, including petitioner, in proportion to their previous holdings of certificates. This amended plan was confirmed by order dated January 19, 1944 (R., p. 94). The order of confirmation is one of the orders appealed from (R., p. 97). However, nothing was done to carry out the plan, nor was the property transferred nor the mortgage satisfied, nor was any stock of the new corporation issued at that time, nor has any stock ever been issued to petitioner.

---

* *Cf.*, the "slanted language" in petitioner's brief (p. 6) that the basis of the objection was failure "to discriminate against" petitioner.

On March 10, 1944, the Court of Appeals of the State of New York decided *Ferris* v. *Prudence Realization Corporation*, 292 N. Y. 210, in which it held that similar certificates similarly reacquired by The Prudence Company, Inc., must be subordinated to the publicly-held certificates. On writ of certiorari, this Court affirmed. *Prudence Realization Corporation* v. *Ferris*, 323 U. S. 650, *supra*.

Respondents, after the decision of the New York Court of Appeals in *Ferris* v. *Prudence Realization Corporation*, but before any action had been taken toward carrying out the plan,* filed in the District Court proposed alterations and modifications of the Trustee's amended plan, so as to incorporate therein the reservation of the question of parity for later determination by a court of competent jurisdiction, in the same manner which was ultimately approved by this Court in the *Ferris* case (R., pp. 106-109). Respondents thereupon moved, pursuant to the Statute, for an order approving the proposed alterations and modifications of the Trustee's amended plan (R., p. 99). Petitioner opposed this (R., p. 110), and the District Court denied the motion (R., p. 114). This order is the second of the orders appealed from (R., p. 126).

Thereafter, on May 31st, 1944, the District Court entered its order of consummation (R., p. 115), directing the carrying out of the plan. Said order is the third of the orders appealed from (R., p. 126).

After the decision of this Court in *Prudence Realization Corporation* v. *Ferris*, some of the respondents moved the District Court for an order under Section 57-k of the Bankruptcy Act, reconsidering and rejecting, according to the equities, the so-called "blanket" proof of claim filed by the

---

* *Cf.*, the statements in petitioner's brief (p. 7) that after confirmation, the plan was "subject *only* to consummation" and that the proposed amendments "sought to alter the finality" of such confirmation. This completely ignores the statute permitting amendments after as well as before confirmation.

Depositary, so as to eliminate therefrom or subordinate t part relating to the certificates reacquired by Prudence, at now held by petitioner, its transferee in bankruptcy (R., d 128-135). This motion was opposed by petitioner (R., p. 13 p. and on March 2nd, 1945, the District Judge denied it ( ), p. 139). On March 6, 1945, the order denying said mot R., was entered (R., p. 139). Said order is the last of the f on orders appealed from (R., p. 141). ur

As heretofore stated, these appeals raised squarely bef ore the Circuit Court the question of the parity of the certifica ites reacquired by the defaulting guarantor.*

* *Cf.*, the provocative language in petitioner's brief at (p. 3) in its st its statement of the questions presented, *e.g.*, abandonment of a "statutory r ry rule", "preference", "collateral attack", etc., used for their affective connotati notations, rather than informative connotations.

SUMMARY OF ARGUMENT.

I. The reversal by the Circuit Court is procedurally correct within the decisions of this Court.

II. The reversal by the Circuit Court is substantively correct within the decisions of this Court.

III. The reasons relied on by petitioner for allowance of the writ are unsound.

A. There is no conflict with the *Geist* case.

1. Petitioner's claim that the Chief Justice was in error, is unsound.

B. The decree of subordination does not "amend the statute", nor does it deprive petitioner of statutory safeguards.

C. The rule postponing realization of a surety's claim until the other claims which it has guaranteed are paid in full, applies to petitioner.

IV. Other arguments scattered throughout petitioner's brief are equally unsound.

A. The certificates in petitioner's hands have no higher status than in the hands of its transferor merely because petitioner is "a creditors' realization corporation".

B. The suretyship relation does exist between petitioner's transferor (Prudence) and the certificate holders.

C. The decree here does not constitute an adjudication between various classes of the holders of guaranty claims.

D. The reacquisitions by Prudence after maturity, after default, and after invocation of the eighteen months' grace clause are different from the acquisitions prior to maturity and prior to default.

ARGUMENT.

POINT I.

THE REVERSAL BY THE CIRCUIT COURT IS PROCEDURALLY CORRECT WITHIN THE DECISIONS OF THIS COURT.

All that the Circuit Court decided was that where a plan for the reorganization of an issue of guaranteed mortgage certificates provided for parity of treatment for all certificates (including those reacquired by the guarantor after default), a motion properly made within the statutory time, which raised the question of subordination, should have been granted by the District Court even though the particular language proposed might not have been finally adopted in the plan. On this state of the record, the Circuit Court could, and did, properly decide that the substantive question of parity was before it, even if only because of the prayer for general relief which was a part of the specific amendments proposed.

In proposing these amendments and in taking the appeals to the Circuit Court, the present respondents were acting as representatives of a class (i.e., all the holders of certificates other than the petitioner Prudence Realization Corporation). The whole class would have been injured by the granting of parity. The Circuit Court of Appeals in refusing to give weight to petitioner's arguments, based upon technicalities of pleading the amendments, was squarely within the principle of *Young* v. *Higbee Co.*, 324 U. S. 204:

> "The appeal here, however, was not from a denial of any individual claim of Potts and Boag. Its basis was that every other preferred stockholder, as well as themselves, would be injured by confirmation. So far as the issues raised by the appeal are concerned, the rights of Potts and Boag and the other preferred stockholders were inseparable. Thus, even though their objection to confirmation contained no formal class suit allegations, the success or failure of the

> appeal was bound to have a substantial effect on the interests of all other preferred stockholders. The liability of one who assumes a determining position over the rights of others must turn on something more substantial than mere formal allegations in a complaint. Equity looks to the substance and not merely to the form" (p. 209).

Further, in its broader aspects, petitioner's argument amounts to saying that the bankruptcy court is powerless to give relief where petitioner itself has stipulated the facts which require that relief; where the Court still retains full jurisdiction and control of the proceeding and of the property involved therein; and where the statute expressly authorizes the procedure employed by the respondents. This argument is precisely the same as the one rejected in *Young* v. *Higbee Co., supra*,

> "THIRD. It is argued that even though the money paid in excess of the stock value does in equity and good conscience belong to the stockholders, the bankruptcy court is without power to award the relief prayed. Courts of bankruptcy are courts of equity and exercise all equitable powers unless prohibited by the Bankruptcy Act. *Securities & Exchange Comm'n* v. *United States Realty Co.*, 310 U. S. 434, 455. The District Court still has jurisdiction to exercise its powers under the Act both because of its express reservation and because of the provisions of § 222.[14] That power is ample to authorize the court to order an accounting for the funds in dispute here. *Pepper* v. *Litton*, 308 U. S. 295, 303-310; *American United Ins. Co.* v. *Avon Park*, 311 U. S. 138, 145-147; *Consolidated Rock Co.* v. *DuBois*, 312 U. S. 510, 521-523" (p. 214).

"[14] This Section gives the judge power, under conditions applicable here, to alter and modify a reorganization plan even after confirmation."

Courts will not be restricted by a pleading demanding a particular form of relief when the facts are so presented that it is clear that relief should be granted even if in different form.

Gins v. *Mauser Plumbing Supply Co.*, 148 F. (2d) 974, 976 (C. C. A. 2nd, 1945):

> "* * * even the demand for judgment loses its restrictive nature when the parties are at issue, for particular legal theories of counsel yield to the court's duty to grant the relief to which the prevailing party is entitled, whether demanded or not. Federal Rules of Civil Procedure, rule 54 (c), 28 U. S. C. A. following section 723c; Ring v. Spina, 2 Cir., 148 F. 2d 647; United States, for Use of Susi Contracting Co. v. Zara Contracting Co., 2 Cir., 146 F. 2d 606, and cases cited."

POINT II.

THE REVERSAL BY THE CIRCUIT COURT IS SUBSTANTIVELY CORRECT WITHIN THE DECISIONS OF THIS COURT.

The relief which the Circuit Court was thus procedurally correct in granting, is also substantively correct and within this Court's decisions enunciating the principles regulating subordination of claims such as those asserted by the present petitioner, i.e., claims acquired by the defaulting guarantor as an incident to its guaranty, and hence asserted under an inadmissible claim of partial subrogation. *Prudence Realization Corporation* v. *Geist, supra; Prudence Realization Corporation* v. *Ferris, supra.*

In the *Geist* case this Court accorded parity to certificates acquired by the guarantor long prior to default, independently of the guaranty, and not as an incident to its partial performance. However, the Court was at pains to point out in the *Geist* case, that where a guarantor's claim was not so acquired, it would be subordinated within the rule of *Jenkins* v. *National Surety Company, American Surety Company* v. *Westinghouse Electric Manufacturing Co.*, and *U. S.* v. *National Surety Company, supra.*

In the *Ferris* case, this Court denied parity where the certificates had been reacquired after default and as an incident to the guaranty. It required such claims to be subordinated —the majority of the Court upon the ground that the reser-

vations in the plan of reorganization required the application of state law (which in turn concededly required subordination), and the concurring minority on the ground that such claims, asserted by virtue of an alleged right of subrogation, were within the rule of the surety company cases, which require postponement of realization by the surety until payment of all other claims which it has undertaken to secure.

The present case is the same, factually, as the *Ferris* case.

Thus, both procedurally and substantively, the action of the Circuit Court of Appeals is affirmatively justified.

POINT III.

THE REASONS RELIED ON BY PETITIONER FOR ALLOWANCE OF THE WRIT ARE UNSOUND.

The first of these reasons is an alleged conflict with the *Geist* case and with *Sampsell* v. *Imperial Paper and Color Corporation*, 313 U. S. 215 (Petitioner's Brief, p. 10).

A. There is no conflict with the Geist case.

It must be clear that the Circuit Court of Appeals did not see any such conflict, nor could it perceive that the Chief Justice thought that his concurring opinion in the *Ferris* case presented any such conflict, for the Circuit Court, quite simply and without possibility of misunderstanding, said (R., pp. 158-159):

> "However, assuming that the *Geist* doctrine is unimpaired, nevertheless we think appellee must lose. For, making that assumption, we take as our guide the concurring opinion of Chief Justice Stone in the *Ferris* case. Regarding the *Geist* doctrine as still possessed of full vitality, he held it inapplicable to the facts of the *Ferris* case, because on those facts, unlike those in the *Geist* case, parity treatment of the certificates held by the guarantor was inequitable, and subordination equitable. The facts here, for all practical purposes, are the same as those in the *Ferris* case. Following Chief Justice Stone's opinion, we therefore hold that subordination here was required."

1. *Petitioner's claim that the Chief Justice was in error, is unsound.*

The alleged conflict must therefore rest only upon petitioner's unfounded assumption that the Chief Justice in his concurring opinion in the *Ferris* case was in complete error on both the law and the facts, and indeed so petitioner does state (Petitioner's Brief, p. 11).

The Chief Justice pointed out that in the *Geist* case Prudence acquired its interest in the mortgage as an original investment before it sold and guaranteed any certificates, whereas in the *Ferris* case Prudence acquired the certificates, on which it based its claim, after it had guaranteed and sold to the public all the certificates and after default. Petitioner claims that the Chief Justice is in error because, it says, both certificate issues were created in the same way (Petitioner's Brief, pp. 10-11). This argument is put forth with such studied naivete as to make it difficult to apply the term "inadvertent error" to its use by the petitioner. Of course both certificate issues were created in the same way. In both cases, Prudence, when it made the original mortgage loan, owned the whole mortgage, and this interest was therefore acquired before any certificates were issued, and therefore necessarily before any guaranty. Prudence did not, in the *Geist* case, sell out the entire mortgage in the form of certificates. Hence its originally-acquired or "residual" rights in the mortgage were the basis of its claim in the reorganization. On the contrary, in the *Ferris* case, as here, Prudence did sell out the entire mortgage in the form of guaranteed certificates. Later, and after default, it reacquired some of the certificates. It is this after-acquired interest which is the basis of petitioner's claim here, as it was in the *Ferris* case. The claims which the guarantor asserted in the *Ferris* case and which it asserts in this case, based on the after-acquired certificates, are therefore entirely different from the claim asserted in the *Geist* case, based on the original investment in the mortgage with which it had never parted.

Hence the Chief Justice in the *Ferris* case was quite correct in making the factual distinction, and the Circuit Court of Appeals in this case was therefore in turn equally correct in adopting the distinction as the *ratio decidendi* of its opinion.

Petitioner's attempt to create a conflict with *Sampsell* v. *Imperial Paper and Color Corporation* (page 12 of its brief), is so transparent that it needs no refutation.

B. The decree of subordination does not "amend the statute", nor does it deprive petitioner of statutory safeguards.

The second of the reasons relied on is the demonstrably fallacious argument that the Circuit Court in decreeing subordination has modified the plan so as to deprive petitioner of the statutory safeguards surrounding the process of the amendment and modification of plans (Bankruptcy Act, § 222), and thereby, *mirabile dictu* has amended the statute! (Petitioner's Brief, p. 16, *et seq.*, especially at p. 18.) This borders on the absurd. Petitioner argues that the Court rejected the precise language of the amendments proposed, but nevertheless subordinated petitioner's certificates. The argument then continues that thereby the plan has been, *ipso facto*, amended, and the District Court need not comply with the statute.

If it is true, as petitioner argues, that the language of the amendments proposed was rejected, then it is equally true that no language to carry out the decree has yet been proposed or accepted. It follows that further proceedings must be had before the District Court to embody in a plan the legal principles which the Circuit Court has laid down. In these proceedings, the District Court must, of course, follow the statute, give notice if required, and possibly even resubmit the plan. Obviously, the Circuit Court did not purport to foreclose the petitioner from these statutory safeguards. What it did was to enunciate the basic legal principles governing future proceedings.

Ring v. *Spina*, 148 F. (2d) 647, 650 (C. C. A., 2d, 1945):

> "But here the trial court's denial of the injunction was based in substantial measure upon conclusions of law which can and should be reviewed because of their basic nature in this litigation. Cf. Bowles v. Nu Way Laundry Co., 10 Cir., 144 F. 2d 741; Bowles v. May Hardwood Co., 6 Cir., 140 F. 2d 1914; Coty, Inc. v. Leo Blume, Inc., 2 Cir., 24 F. 2d 924; Schey v. Turi, 2 Cir., 294 F. 679. The case then should be remanded for action by the District Court in the light of the legal principles thus enunciated."

Moreover, subordination is not the equivalent of elimination. Petitioner's participation in the plan remains to be fixed on the basis of a valuation of the debtor's assets. If the value of the debtor's real estate and other assets is more than the amount due to the prior certificate holders, then petitioner may participate in the plan. Until this value is established, petitioner's right to participate and the extent of such participation remain undecided. It is simply ridiculous to say that the Circuit Court decided any more than the basic legal proposition which must underlie future proceedings in the District Court.

C. The rule postponing realization of a surety's claim until the other claims which it has guaranteed are paid in full, applies to petitioner.

At pages 19 to 24, petitioner argues a third reason for the allowance of the writ, to wit: that the Circuit Court erroneously applied to an insolvent guarantor the rule of non-competition claimed to apply exclusively to solvent sureties.

Petitioner seeks to derive support for this claim from a passage in the opinion in the *Geist* case, but a closer reading of the opinion will demonstrate that the only effect of the surety's insolvency is to eliminate circuity of action *as a sole basis* for subordination without, however, eliminating or affecting the other bases, such as inequitable conduct in the acquisition of the asserted claim (316 U. S. at p. 97). Despite assertions to the contrary by petitioner, the insol-

vency of the guarantor has no other significance. This appears clearly from the Chief Justice's concurring opinion in the *Ferris* case and also from *In re Prudence Bonds Corporation,* 102 F. (2d) 531, 534 (C. C. A., 2d, 1939), in which the rule of non-competition was applied to this very guarantor in a bankruptcy reorganization proceeding. The Court said:

> "The Prudence Company, that guaranteed the debt, is seeking to realize upon the collateral before paying off the whole of the obligation to secure which the collateral was given. This is contrary to the established rule in cases of subrogation."

The application of the rule of non-competition to an insolvent guarantor was further recognized in connection with this same guarantor's securities in the reorganization of Prudence-Bonds Corporation when bonds guaranteed by The Prudence Company, Inc., and reacquired by it under similar circumstances, and aggregating $1,910,300 in principal amount, were subordinated. The Special Master's Report of December 8, 1936 (filed in the reorganization of Prudence-Bonds Corporation, No. 26545, in the United States District Court for the Eastern District of New York) said in part (p. 25):

> "The Bonds * * * which were reacquired by The Prudence Company, Inc., after the sale thereof to the public were not intended to be and were not investments of The Prudence Company, Inc., but were, and were intended to be, acquired in reduction *pro tanto* of the liabilities of The Prudence Company, Inc., on its guaranties."

The District Court confirmed this report, and in an opinion dated January 28, 1937, Inch, *J.*, said:

> "In my opinion the careful and learned report of the Special Master should be and is confirmed. I agree with him that the evidence clearly shows that the motive of The Prudence Company, Inc., in purchasing these bonds in question was not to invest therein, but to reduce, with as much secrecy as possible, its own obligations represented by its guaranty."

Prudence appealed. The appeal was settled and withdrawn before argument, but the bonds remained subordinated.

> Record on Appeal in *Prudence Realization Corporation* v. *Geist*, page 20.

Further, petitioner here is not insolvent and never has been in bankruptcy. With respect to the reacquired certificates, for which it is claiming parity of treatment, it is no more than a transferee of the certificates at a bankruptcy sale, and hence can acquire no greater rights than existed in its bankrupt predecessor The Prudence Company, Inc.

> *Smith* v. *Chase National Bank*, 84 F. (2d) 608;
> *In re Moose River Lumber Co.*, 251 Fed. 409;
> *Matter of Lawyers Title & Guaranty Co.*, 287 N. Y. 264-273.

This is particularly true when the guarantor's plan of reorganization, under which petitioner alone can claim any rights, and the District Court's order directing the transfer of the certificates to petitioner, clearly envisaged the possibility of subordination and specifically preserved the equities of third parties (R., p. 71).

POINT IV.

OTHER ARGUMENTS SCATTERED THROUGHOUT PETITIONER'S BRIEF ARE EQUALLY UNSOUND.

A. The certificates in petitioner's hands have no higher status than in the hands of its transferor merely because petitioner is a "creditors' realization corporation".

Petitioner urges in several places in its brief, sometimes directly, such as at page 20, and sometimes indirectly, such as at page 6, that it has a better position and a higher standing than its transferor Prudence, because, it says, it is a creditors' liquidating corporation. Just why and how this

benefits petitioner is not explained, and indeed it is impossible to explain. Subordination, if it took place at all, took place long before the bankruptcy, and hence had diminished the value of assets in the bankrupt's hands. The reacquired certificates had become in effect a second mortgage, and nothing in the bankruptcy proceeding could operate to fix a greater value for these assets or to establish in petitioner's hands a higher priority of lien than existed in the hands of its transferor. Insofar as petitioner claims to be representative of all the creditors of the present debtor, the absurdity of its claim must be perfectly clear by the very reason of its adversary position on this appeal.

B. The suretyship relation does exist between petitioner's transferor (Prudence) and the certificate holders.

Petitioner also apparently claims that Prudence was not a surety, arguing that Prudence was engaged primarily in the business of making loans and only incidentally guaranteed them (Petitioner's Brief, p. 21). There is nothing in this record to indicate the relative importance of these two phases of the business of the defunct Prudence Company, but the facts remain that it did guarantee the certificates and did establish the relation of principal and surety, and that it sold the certificates only as guaranteed investments. If we are to make any assumptions and go beyond the record, as petitioner does on page 21, it seems much safer to assume that the well advertised guarantee loomed large in the minds of the investing public as an inducing cause of the purchase of the investment.

Moreover, the relation of principal and surety existing between Prudence and the certificate holders was coupled with a fiduciary relation of the strongest character in that the certificates which Prudence guaranteed and sold made Prudence the agent of the certificate holders to service, administer, and enforce the mortgage, to make all collections of principal and income, to distribute the same to the certificate holders, and, after paying them in full, to keep the overplus, if any, for itself (R., p. 25).

C. Subordination does not constitute an adjudication between various classes of holders of guaranty claims.

Petitioner further seeks to make an issue reviewable by this Court by arguing that the effect of subordination is an adjudication of equities between one group of guarantee creditors and all other creditors of the insolvent guarantor (Petitioner's Brief, top of p. 13). Here again petitioner is confusing the reorganization of its predecessor Prudence and the unsecured guarantee claims affected thereby, with the reorganization of the present debtor and the secured claims involved herein.

Clearly, it is impossible in this reorganization, which involves only the mortgage claims against the real property of the debtor 1934 Realty Corporation, to make any "adjudication of equities between one group of guaranty creditors and all other creditors of the insolvent guarantor", as petitioner claims is being done (Petitioner's Brief, top of p. 13 and bottom of p. 24). Guaranty claims against the insolvent guarantor are not involved in this reorganization at all. The only claims being reorganized in this proceeding are the secured claims against this debtor's property. The priority sought is not one against other creditors of the guarantor, but over the guarantor's own claim against this very debtor.

Moreover, the guarantor's own reorganization plan contemplated that certain certificates would be subordinated and made specific provision for that eventuality (R., pp. 71, 152). Even the order transferring the assets to the present petitioner made the transfer subject to the equities of third persons. The guarantor's plan of reorganization has been confirmed, and no appeal was ever taken. The order confirming the plan of reorganization is *res adjudicata*. *Chicot County District* v. *Bank*, 308 U. S. 371, 378. Petitioner cannot complain that the possibility forseen in the plan, under which it alone has any claim to the certificates involved in this proceeding, has become an actuality.

D. The reacquisitions by Prudence after maturity, after default, and after invocation of the eighteen months' grace clause are different from the acquisitions prior to maturity and prior to default.

Petitioner attempts, at several places in its brief, to assimilate its practice in acquiring certificates prior to maturity to its reacquisitions here after maturity and after default. At some places this is done by innuendo, as at page 4 of petitioner's brief, in what purports to be a statement of facts. There petitioner says that the certificates were repurchased "as part of its business". See also top of page 6. Sometimes the claim is more directly put forth, as at the bottom of page 21 and the top of page 22. It may be true that Prudence sought to keep its customers, and that business necessities required that it do so. Nevertheless, its business necessities do not exempt it from the legal consequences which follow upon the practices which it pursued.

Moreover, so long as Prudence had not suspended principal payments and could meet demands for the full payment of its guaranty obligations, it might well be that the voluntary acceptance by a certificate holder of a different certificate in another issue, maturing at a later date, would constitute, as between Prudence and that particular customer, an accord and satisfaction of the guaranty obligation attaching to the original certificate turned in and exchanged. However, with the suspension of principal payments, with the obvious inability of the guarantor, as shown by its balance sheets, to meet its obligations, and with the Tigo certificates and the mortgage itself in default, new elements were introduced which made it impossible for the more or less forced sales at discounts to constitute performance of the guaranty by Prudence. As soon as the eighteen months' grace clause was invoked, the certificate holder no longer had a voluntary choice of accepting cash or the proffered new investment, nor, on the other hand, did Prudence have the ability to meet the demand for cash. All the certificates here in suit were acquired after the introduction of these elements, and if Prudence, more realistically surveying the situation and

with greater regard for its guaranty obligation and the ful fillment of its fiduciary obligation toward the certificat holders, had made pro rata payments instead of grossly dis criminating as it did, it would be perfectly clear that no claim based on the partial pro rata payments, could be al lowed here in competition with the other certificate holder

Finally, in order completely to refute the argument tha the acquisitions were made as a part of the regular practic of the Company, it need only be pointed out that never before had there been a suspension of principal payments, tha never before had there been an application to Reconstruction Finance Corporation for a loan necessary for the Compan "to keep on as a going concern" (R., p. 51), never before ha there been set up a Pender-Buckbee-Merriam account for th purchase of certificates on the market, and never before ha there been set up a committee to make purchases at the bes prices obtainable where the holder urged a claim of distres (R., pp. 53-55).

It thus appears that none of petitioner's arguments, de spite their "loading" and "slanting", withstand analysis.

CONCLUSION.

Since the Circuit Court's decision was clearly within do trines often reiterated by this Court, both procedurally an substantively, the only purpose served by the granting of th writ would be a restatement of the same principles. Pet tioner has shown no reason for a third review of the sam question, and its petition for a writ of certiorari should b denied.

Respectfully submitted,

EUGENE BLANC, JR.,
Counsel for Respondent

(27)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 223

IN THE MATTER OF 1934 REALTY CORP.,

Debtor.

PRUDENCE REALIZATION CORPORATION,

Petitioner,

v.

THE HURD COMMITTEE, THE PETITIONING CREDITORS, AND CARROLL DUNHAM, 3RD, AND EDWARD K. DUNHAM AS TRUSTEES OF THE ESTATE OF DAVID DOWS,

Respondents.

REPLY BRIEF ON BEHALF OF PETITIONER, PRUDENCE REALIZATION CORPORATION

IRVING L. SCHANZER,
Counsel for Prudence Realization Corporation, Petitioner.

INDEX

CASES CITED

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 223

IN THE MATTER OF 1934 REALTY CORP.,

Debtor.

PRUDENCE REALIZATION CORPORATION,

Petitioner,

v.

THE HURD COMMITTEE, THE PETITIONING CREDITORS, AND CARROLL DUNHAM, 3RD, AND EDWARD K. DUNHAM AS TRUSTEES OF THE ESTATE OF DAVID DOWS,

Respondents.

REPLY BRIEF ON BEHALF OF PETITIONER, PRUDENCE REALIZATION CORPORATION

I

As to the brief of The Hurd Committee, et al., Respondents

1. Petitioner is satisfied that a more careful reading of the record here by counsel for these respondents would

have obviated any reference to "loaded words" and "slanting expressions". Record references contained in the petition document the accuracy of the facts outlined in the petition.

2. In seeking to justify the procedure adopted by the Circuit Court of Appeals in reversing the District Court's decision here, respondents appear to have misunderstood petitioner's position.

Petitioner does not question the equity powers of the bankruptcy court. Equity, however, means equity as between all of the parties. Here, respondents sought, not a determination of status, but a reservation of the question in such form as to cut off all rights of petitioner under the Bankruptcy Act by having its claim determined upon rights as they existed immediately prior to the filing of the reorganization petition, and to oust the federal court of jurisdiction to determine the issue as a matter of federal law. Petitioner met that issue. No further proof was necessary to show the invalidity of the proposed amendments under the Bankruptcy Act. That was a question of law only.

If the issue of subordination was to be presented, petitioner was entitled to know it—to prepare for it—to meet it by additional facts showing the manner in which other certificate holders in the same issue had acquired their certificates, whether for speculation or investment, the prices paid, and any other facts which would permit a proper application of equity rules to the matter of participation in the proceeds of the mortgaged property.

No appeal having been taken from the order allowing petitioner's claim on a parity with other certificate holders, and the plan following that order having been confirmed, the court could not amend the plan on its own motion. Even the Circuit Court of Appeals recognized the fact that some request by respondents was necessary to give the court a basis upon which to consider the issue of subordination. Petitioner urges that the court was in error in

utilizing a general prayer for relief as such basis; that equity insures to petitioner its opportunity to be heard and to defend against the claim asserted, not against the variations which speculation and ingenuity may make in that claim.

Nothing in *Young* v. *Higbee Co.*, 324 U. S. 204, cited by respondents, alters that conclusion. On the contrary, this Court, in reaching the decision in that case, reaffirmed the protective function of equity.

Since the Circuit Court dismissed the appeal from the order confirming the plan (R. 159, 160), the ruling here is that the offer of a specific amendment gives the appellate court jurisdiction and power, on its own motion, to disregard the invalid amendment and to vacate an earlier and final order allowing a claim. Such ruling presents a question of procedure and administration which should be reviewed by this Court.

3. Respondents dispute the statement in the petition that Chief Justice Stone, in his concurring opinion in *Prudence Realization Corporation* v. *Ferris*, 65 Sup. Ct. 539, at 542, overlooked the fact that in that case, as in *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, Prudence had acquired its interest in the mortgage as an original investment before it sold and guaranteed certificates.

In the *Geist* case, as in the *Ferris* and in the present cases, Prudence made the original investment and transferred the mortgage to Prudence Bonds Corporation. In the *Geist* case, all but a $7,200 interest in the mortgage was certificated. The uncertificated portion of the mortgage was subsequently acquired by the Prudence trustees from the trustees of Prudence Bonds Corporation in the settlement of mutual claims between the two companies (*Prudence Realization Corporation* v. *Geist, supra*, at p. 91). That, however, was not the first investment by Prudence. Since Prudence had originally made the loan with its own money, the giving of a further consideration by its trustees